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## GLOBAL ASSET MANAGEMENT & PRIVATE BANKING CREDIT POLICY MANUAL

UPDATE: 04/1/98

SECTION: VI. APPENDICES  
SUBSECTION:  
TITLE: Extensions of Credit Secured by Stock, Bonds, etc.

### CROSS-REFERENCES/RELATED TOPICS

(Corporate Credit Manual)

Structuring Credit Exposure (II-5)

Extensions of Credit Secured by Securities of CMC (V-4)

Restrictions on Affiliate Transactions (VI-14)

The Bank extends credit secured by corporate, government and municipal securities. Although the extension of credit is secured, it is imperative that the Responsible Officer "know the borrower," its background, and financial responsibility, and the purposes for which the loan is sought.

It is equally important that the Responsible Officer determine the quality of the proposed collateral and perfect the Bank's security interest in this collateral prior to the disbursement of funds. Liquidity, concentration and price volatility, in addition to a security's external ratings (provided by recognized agencies such as S&P and Moody's), are important considerations in determining its quality. If the Responsible Officer is unfamiliar with the proposed collateral, then the Credit Executive and other appropriate areas of Chase should be consulted in evaluating the quality of these securities.

### LEGAL ISSUES

The Responsible Officer must be aware of the following legal issues as they relate to the acceptance of securities as collateral, and where appropriate, consult with their Credit Executive and/or counsel before credit approval of the proposed transaction. *Failure to detect and address these legal issues in a timely manner may, at best, result in adverse business consequences; at worst, the Bank and the Responsible Officer could be subject to criminal and civil liabilities and the loans or other credit so collateralized could be voided.*

- **Reg. U:** This Federal Reserve Board regulation imposes restrictions on Bank extensions of credit which are (1) for the purpose, whether immediate, incidental or ultimate, of purchasing or carrying "margin stock" and (2) are secured directly or indirectly by margin stock (as defined below). One restriction is a ceiling on the amount that may be advanced (currently 50%) against collateral that consists of margin stock. In addition, a Form FR U-1 must be executed by the customer and Responsible Officer at the time the credit is extended (or, in the case of a revolving credit or an agreement permitting multiple draws, at the time the credit agreement is signed) if the credit is secured directly or indirectly by "margin stock" in an amount exceeding \$100,000.

"Margin stock" is defined in the regulation, and includes: (i) any equity security registered or having unlisted trading privileges on any national securities exchange, (ii) any security trading on the

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NASDAQ National Market System (NMS), (iii) any debt security convertible into, or carrying a warrant or right regarding, a margin stock, (iv) any warrant or right to purchase a margin stock and (vi) with certain very limited exceptions, (one exception being money market mutual funds), any security issued by an investment company (i.e., all mutual fund shares or units, including Vista Funds).

- **Section 23A and 23B of the Federal Reserve Act:** (See Section VI-14: *Restrictions on Affiliate Transactions*.) These provisions, which regulate transactions with affiliates, deem any credit transaction with any person to be an affiliate transaction if secured by debt or equity securities or similar obligations of an affiliate of the Bank. As defined, affiliate includes, among others, The Chase Manhattan Corporation, certain of its subsidiaries and all of the Vista Funds. Credit transactions secured by the securities of an affiliate, together with the outstanding amount of all other transactions covered by Section 23A, may not exceed specified percentages of the Banks capital. Availability within those percentages is monitored, and must be pre-cleared by, the *Office of the Treasurer*. The Firewalls imposed by the Federal Reserve, the New York State Banking Law and Bank policy also affect the use of securities and similar obligations of affiliates as collateral for loans. (See Section V-4: *Extensions of Credit Secured by Securities of CMC*.)
- **Federal Securities Law Restrictions:** The Bank's ability to liquidate securities pledged as collateral to recover on a defaulted loan may be restricted by various provisions of the Federal securities laws, including those pertaining to the sale of Restricted Securities, Control Securities, Rule 145 Securities or the sale of securities when in possession of material inside information concerning the issuer of the securities.
  - **Restricted Securities:** Restricted Securities include securities acquired through a private placement, a Rule 144A or Regulation D offering or often, through employee benefit plans. Often (though not always) the certificates for restricted securities have legends indicating their restricted status.
  - **Control Securities:** Control Securities are securities which are held by a person who is in a control (affiliate) relationship with the issuer of the securities. Whether a person controls an issuer is ordinarily a question of fact. Persons with the power to direct the management and policies of an issuer are regarded as control persons. Usually this includes directors, executive officers and significant shareholders. (10% is often used as a guideline but is not a bright-line rule).
  - **Rule 145 Securities:** Rule 145 Securities are securities which were acquired in a reclassification, merger, consolidation or asset transfer by a person in a control (affiliate) relationship with a party to the transaction.
  - **Inside Information:** Inside information is non-public information concerning an issuer of securities. As a lender to the issuer or as a lender to a person who has such information (such as a control person) and who shares it with the Bank, the Bank or its representative may possess material non-public information concerning an issuer.

The relevant securities law limitations, if applicable, may preclude the Bank, as pledgee, from selling the securities collateral unless, in the case of restricted or control or Rule 145 securities, the securities either are registered with the SEC or an exemption (such as Rule 144) or for Rule 145 securities, provisions of Rule 145 applies or, in situations where the Bank or its representatives may have material non-public information concerning the issuer of the securities, until such information is publicly known or has become immaterial.

- **Stockholders Agreements, Lock-ups, Affiliates Agreements and Other Contractual Restrictions on Transfer or Pledge:** Stockholders may enter into agreements containing

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provisions restricting pledges and transfers of the stock. Major stockholders of closely-held corporations often enter into stockholders agreements controlling the disposition of control blocs (even if the rest of the company's stock is publicly traded). They also may have entered into lock-ups (agreements with the issuer of the securities or its underwriters not to sell for specific periods of time, such as 180 days). Affiliates Agreements (similar to lock-ups) are often requested of substantial stockholders or control persons in connection with mergers and acquisitions where new stock is issued. Similarly, other agreements may restrict the sale or pledge of stock acquired in exchange for defaulted debt. Often, but not always, the existence of such contractual restrictions may be legended on the stock certificate(s) involved.

Depending on the nature of these contractual restrictions, they may, at the very least, limit the manner of sale or potential buyers to those specified in the contract or, at worst, void the Bank's security interest.

- **Restrictions Applicable to Securities Underwritten, Privately Placed or Dealt in by Chase Securities Inc. (Firewalls):** Among other things, the Firewalls prohibit the Bank from knowingly extending credit secured by (or for the purpose of purchasing) (i) ineligible securities underwritten or privately placed by Chase Securities Inc., for the applicable blackout period, and (ii) ineligible securities in which Chase Securities Inc. makes a market, for so long as CSI is a market maker. (See Section VI-14: *Restrictions on Affiliate Transactions*.)

### Collateral

The following charts indicate current Bank guidelines as to *maximum* percentage advances against a diversified portfolio of securities pledged to secure extensions of credit *not* subject to the above-mentioned Regulations. This percentage advance should not be exceeded during the life of the credit, and it is imperative that the margins be monitored on a regular basis. These guidelines were established to create an awareness of the attributes of collateral risk rather than to serve as a substitute for careful analysis of the specific credit. Guidelines can not identify every acceptable or unacceptable collateral mix. Accordingly, responsible Officers should use advance rates lower than these maximum guidelines where the circumstances warrant.

Any variances to the guidelines, including the acceptance of collateral that is generally ineligible, should be handled in accordance with Group procedures, with exceptions appropriately approved and documented in the credit proposal.

The applicable percentage advance (whether the maximum permitted by the guidelines or a lower advance rate) is computed on bid prices for over-the-counter securities and on closing prices for securities traded on organized exchanges, daily or as frequently as an issue is priced.

The following advance rates do not apply to the Wall Street Unit, or non Private Bank foreign offices. Those offices should consult their Credit Executive for the appropriate guidelines. Additionally, the advance rates for capped derivatives transactions can be found in Policy IV-5: Derivative Products.

All securities accepted as collateral other than securities deposited pursuant to fiduciary arrangements approved by Chase Legal, and securities held in Chase name at CEDEL and/or Euroclear should be in the possession or control of the Bank. Physical (certificated) securities should be held in the appropriate loan administration or custody area or, if possible, converted to book entry form by depositing the securities in Chase's account at a clearing corporation (such as The Depository Trust Company). Except

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for securities accepted as collateral by the Wall Street Unit or any other unit that maintains approved monitoring and custody capabilities, book entry items should be administered by Private Banking Custody (PBC). Contact PBC to establish a securities collateral account and consult the Legal Department concerning the Banks security interest in the collateral. *If there are exceptional circumstances and the securities are being held by a third party (e.g., a brokerage house), then the documentation stipulating the responsibilities of the third party must be approved by the Legal Department and a Credit Executive prior to accepting this collateral custody arrangement.*

For collateral not addressed in this Guideline, such as ADRs, very small cap stocks, discretionary investment portfolios or other forms of liquid collateral, advance ratios and collateral upgrades require approval by a Credit Executive.

**Facility Risk Grading:** The collateral value after application of approved advance rates must be utilized to determine the appropriate upgrade in the collateral step of the Facility Risk Grading System. For a facility to enjoy the full upgrade allowed in this step, the loan-to-value should not be higher than the Percentage Advance indicated in the Guideline. A higher loan-to-value may be approved either by a Credit Executive or in accordance with Group Procedures. In these instances, the collateral upgrade must be reconsidered, and the allowable improvement adjusted accordingly.

## CRITERIA GOVERNING EXTENSIONS OF CREDIT SECURED BY STOCKS, BONDS, ETC.

- Margins *exclude* currency risk; see Cross-Currency Guidelines herein.
- Market capitalization equals the number of outstanding shares multiplied by the market value per share.
  - A **Very Large Capitalization** stock has a market capitalization of over \$10 Billion.
  - A **Large Capitalization** stock has a market capitalization of over \$1 Billion to and including \$10 Billion.
  - A **Medium Capitalization** stock has a market capitalization of over \$500 Million to and including \$1 Billion.
  - A **Small Capitalization** stock has a market capitalization of less than \$500 Million but greater than \$250 Million.

Equities must be marginable, salable within one to two days and not subject to any legal or contractual restriction, nor represent more than 5% of the outstanding shares of any single issuer. Exposure to a given stock should not be significant in relation to its average daily trading volume and liquidation of the Banks exposure, and should not exceed the total trading volume over two consecutive trading days, based upon an analysis of average daily volume over the prior three months. Variances may only be approved in accordance with Group Procedures, or by a Credit Executive.

- Equities must also have been traded on a recognized exchange for a minimum of 12 months. In any event, consult with your Credit Executive for guidance.
- A lower advance rate should be applied if (a) 10% of the collateral (in relation to total facility amount) consists of a single equity or (b) the absolute loan value (e.g., net of margin) in one issue exceeds the following limits:
  1. A rated stock: \$25 MM
  2. A- rated stock: \$10MM
  3. B-, B, B+ rated stock: \$5MM
  4. US Govt. & Agency Bonds & 1-3 Grade non-US Govt. Bonds: \$50MM

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5. Investment Grade Municipal Bonds: \$10MM
6. Investment Grade Corporate Bonds/Eurobonds: \$10MM

- However, small dollar amount facilities secured by highly liquid stocks in concentrations of greater than 10% may fall within the standard advance rates. Consult your Credit Executive for an acceptable percentage advance and Facility Grade, and document the justification for accepting this collateral.
- Higher concentrations may be approved in accordance with Group Procedures.
- More conservative advance rates should be applied if there is significant speculative activity in a particular stock (for example, based on a rumored acquisition). This should also be considered when monitoring the margins once a stock has been accepted as collateral.
- The attributes of the securities to be pledged should also be carefully examined from a portfolio perspective. Determine, e.g., whether the characteristics of the securities or the issuers are such that they would cause the portfolio as a whole to perform poorly (for example, if all of the issuers were dependent on exports to the same developing country).
- When a US stock is selling below \$10/share, consult your Credit Executive. The Credit Executive may approve an advance rate for such collateral provided the justification for accepting this collateral is documented.
- Variations to margins set forth herein may only be approved in accordance with Group Procedures.

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## EQUITY ISSUES & OTHER INSTRUMENTS

Type of Collateral	Maximum Percentage Advance
Cash, MMAs, CDs and TDs issued at/held by Chase or fiduciary deposits with Chase units (same currency)	100%
CDs and TDs, or fiduciary deposits held by other banks rated 1-3 (same currency)	90%
Structured deposits < 5 years [(only Private Banking Group (same currency))]	50-95% of guaranteed principal amount (depending on tenor and yield)
US common & preferred stocks minimum \$10/share NYSE, AMEX (main board), NASDAQ (NMS)	
Very large cap:	80%
Large cap:	75%
Medium cap:	70%
Small cap:	50%
Non-NMS OTC (FED list)	50%
Foreign equities and sponsored ADRs	To be approved either: <ol style="list-style-type: none"> <li>1. on stock by stock basis by Credit Executive, taking into account (a) rating, if any (b) liquidity per US standards, (c) diversification per US standards, (d) market cap per US standards, and (e) share price; or</li> <li>2. under Private Banking Group programs covering special markets/exchanges by Group Credit Executive.</li> </ol>
Mutual Fund shares:	70% against US Funds which are:
• Mutual Funds	<ul style="list-style-type: none"> <li>• at least 80% in investment grade assets/cash in accordance with written (or stated) investment criteria of the Fund</li> <li>• listed/priced daily</li> <li>• listed in Morningstar</li> <li>• denominated in US \$</li> </ul>
• Non-US Mutual Funds	All other funds require case-by-case analysis and approval by Credit Executive

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- In-house US Funds (e.g.; Vista)
- In-house Non-US Funds (e.g.; Vista, MAP,)

## Discretionary Investment Portfolios

Require case-by-case analysis and approval by a Credit Executive

Subject to 23A allocation approval. Margins TBD\*

Subject to 23A allocation approval. Margins TBD\*

Approval on a case-by-case basis by a Credit Executive.

\* To be determined (TBD).

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## DEBT ISSUES

Type of Collateral	Maximum Percentage Advance
<b>US GOVERNMENT</b>	
· Treasury Bills (< 1 year)	95%
· Treasury Notes (< 2 years)	95%
· Treasury Notes, Bonds (> 2 years)	90%
· Zeros	80% (of market value)
<b>US AGENCIES</b>	
· < 2 years maturity	95%
· 2 years to 10 years maturity	90%
· > 10 years maturity	85%
<b>OTHER GOVERNMENTS (Same Currency)</b>	90% for 1-3 rated countries
<b>COMMERCIAL PAPER **</b> (excluding Chase paper)	
· A1+/A1/P1	95% if < 270 days 90% if > 270 days
<b>US MUNICIPAL BONDS **</b>	
· Aaa/AAA	90%
· Baa/BBB or better	80%
	%
<b>CORPORATES/US &amp; EUROS **</b>	
· Straight/Floaters/BBB, Baa2, 1 or better	80%
· Convertibles, Zeros/A or better	60% (of market value)
· Convertibles/BBB-, Baa3 or better	50%
· Straight/Floaters/BBB-, Baa3	50%

\*\* As rated by Moodys and S&P. If split rating, use lower rating.

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## OTHER

Type of Collateral	Maximum Percentage Advance
CROSS-CURRENCY	10% additional margin for ANY cross-currency exposure with currencies on approved list (see below).
FOREIGN CURRENCIES	Restricted to specified list (Majors plus European currencies as approved by Group Credit Executive).
GOLD	70%
SILVER	60%
STANDBY LETTERS OF CREDIT	Limited to banks graded 1-3. Allocation and grade approved by Financial Institutions Group.
INTER-BRANCH BLOCKAGES	Risk assumed by another Unit of Chase
ACCRUED DEPOSIT AND BOND INTEREST	80% net of loan interest. <i>Only</i> in approved international locations where Bank can track net accrued interest on automated basis.

## INELIGIBLE

Type of Collateral	Maximum Percentage Advance
JUNK BONDS	0%
COLLATERALIZED MORTGAGE OBLIGATIONS (CMOs)	0%
DERIVATIVES - ALL INSTRUMENTS	0%
BONDS TRADING BELOW 70	0%
EMERGING MARKET FUNDS	0%
SAVINGS BONDS - SERIES E & H	0%

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